Directive 10-5: Further Guidance Regarding the Application of the Combined Reporting Regulation, 830 CMR 63.32B.2

I. Introduction

For taxable years beginning on or after January 1, 2009, a corporation is required to file a combined report when it is subject to tax under General Laws chapter 63 and engaged in a unitary business with one or more other corporations that are required to file a combined report pursuant to G.L. c. 63, § 32B. The rules that apply under G.L. c. 63, § 32B are set forth in the combined reporting regulation, 830 CMR 63.32B.2. This Directive illustrates the application of several of the rules that are set forth in 830 CMR 63.32B.2. In particular, this Directive illustrates the application of the rules set forth in:

(i) 830 CMR 63.32B.2(6)(c)4., as it pertains to a combined group's reporting of REIT dividends;

(ii) 830 CMR 63.32B.2(6)(c)8, as it pertains to a combined group member's calculation of its capital gains and losses and Internal Revenue Code § 1231 gains or losses;

(iii) 830 CMR 63.32B.2(8)(f), as it pertains to the calculation of the limitation that applies with respect to the use by a taxable combined group member of a Massachusetts net operating loss carry forward that it derived in a tax year prior to becoming a member of the combined group; and

(iv) 830 CMR 63.32B.2(8)(g) and 830 CMR 63.32B.2(8)(h), Example 7, as those provisions pertain to the relationship between allocable and apportionable losses and loss carry forwards. In particular, this Directive corrects the illustrative example set forth at 830 CMR 63.32B.2(8)(h), Example 7, which is partially erroneous.

II. Application of 830 CMR 63.32B.2(6)(c)4; tax treatment of a distribution made by a real estate investment trust to a shareholder corporation where the two corporations are under common ownership and members of a combined group

The combined reporting regulation, 830 CMR 63.32B.2, includes detailed rules that explain the computation of a combined group's taxable income, but does not specifically state the rules that apply in the context of an income distribution made by a real estate investment trust to a shareholder corporation where the two corporations are under common ownership and engaged in a unitary

business and the income distributed derives from such unitary business, or alternatively where the two corporations are members of a combined group that is subject to an affiliated group election. The specific treatment of such income distributions is as set forth below.

A real estate investment trust (REIT) as defined under the Internal Revenue Code (Code) is accorded special federal income tax treatment pursuant to Code §§ 856-859. Pursuant to those Code sections, a REIT that distributes 90% or more of its annual net income may claim a deduction for the amount of the income distribution, and the income distribution will be taxable to the recipients at the shareholder level. The Massachusetts income tax rules that govern the treatment of REITs are generally the same as those set forth under the Code. Thus, for example, where a REIT distributes 90% or more of its annual net income to its shareholders, including one ore more corporate shareholders, the income distributed to such shareholders, including the corporate shareholders, is subject to tax. *See* G.L. c. 63, §§ 1, 30.4 (pertaining to financial institutions and general business corporations, respectively). *See also* TIR 03-09; DD 02-12. For purposes of this analysis, it is significant that while a distribution of income from a REIT is generally termed a dividend under the Code, it is not treated as a dividend within the meaning of the federal and Massachusetts rules that determine a "dividends received deduction," and thus a corporation's receipt of an income distribution from a REIT is not deductible by that corporate shareholder for either federal or state income tax purposes. *See* TIR 03-09; DD 02-12. These latter rules help to ensure that REIT income will be subject to a single level of tax for federal and state income tax purposes. *See id.*

In some cases a REIT must be included in a combined report pursuant to G.L. c. 63, § 32B because it is commonly owned by and engaged in a unitary business with one or more other corporations, and one or more members of the unitary group are subject to tax in Massachusetts. *See* 830 CMR 63.32B.2(4)(b). In these cases where the REIT distributes more than 90% of its annual net income derived from the unitary business to its shareholders, any such income distributed to a combined group member will be considered a dividend that is eliminated from the combined group's taxable income. *See* 830 CMR 63.32B.2(6)(c)4.a (stating, *inter alia*, "[d]ividends paid by one combined group member to another combined group member shall, to the extent those dividends are paid out of earnings and profits of the unitary business included in the combined report, from the current … year, be eliminated from the income of the recipient"). Further, since the dividend transaction and its consequences are eliminated, there is no deduction available to the REIT in connection with the payment of the income distribution to the combined group member. This same result follows where the REIT paying the dividend and the corporation receiving it are members of a combined group subject to an affiliated group election, irrespective as to whether the income is unitary business income. *See generally* 830 CMR 63.32B.2(10).

The following example illustrates the above-stated rules.

Example 1. During the 2009 taxable year, corporation P owns 60% of corporation S, which is a REIT within the meaning of Code §§ 856-859. P and S are engaged in a unitary business and the two corporations are required to file a combined report pursuant to G.L. c. 63, § 32B. Assume that both corporations have a taxable year-end of December 31 and that all of S's income in tax year 2009 is income that derives from the unitary business. Also assume that the remaining 40% ownership interest in corporation S is owned by shareholders that are not members of the combined group. Further assume that S has previously paid out to its shareholders all of its income from prior tax years and that, therefore, for its 2009 tax year S has no accumulated earnings and profits that relate to prior tax years.

During the 2009 tax year S has net income from its real estate operations of $100,000, which is to be included in the combined group's taxable income. Near the end of its 2009 tax year S distributes $60,000 of this income to P, and the remaining $40,000 to its other shareholders. S has no other income for the taxable year. Because P and S are members of the same combined group and the REIT distribution relates to the two corporations' unitary business, the income paid by S to P is eliminated from the combined group's taxable income pursuant to 830 CMR 63.32B.2(6)(c)4. Further, because this transaction between S and P is eliminated from the combined group's taxable income there is no deduction permitted to S for the payment of the dividend to P. In addition, P as a corporate shareholder of a REIT would not be permitted to claim any dividends-received deduction for the receipt of the dividend from S (even apart from the elimination of the dividend and its consequences in the combined report). *See* 830 CMR 63.32B.2(6)(c)4.b.

In contrast, the income paid by S to its other shareholders that are not included in the combined group is not subject to elimination but rather results in income on the part of those shareholders, which is subject to Massachusetts tax if the recipient is subject to Massachusetts tax. If one of these recipients is a corporation, no dividends received deduction is allowed to that corporation upon the receipt of this income. G.L. c. 63, §§ 1, 30.4. Further, the distribution by S to its other shareholders that are not included in the combined group is deductible for Massachusetts purposes. Therefore, S is entitled to a deduction for its payment of $40,000 to its shareholders that are not included in the combined group.

III. Application of 830 CMR 63.32B.2(6)(c)8; a combined group member's calculation of capital gains and losses and Internal Revenue Code § 1231 gains or losses

The combined reporting regulation at 830 CMR 63.32B.2(6)(c)8 includes a provision that is intended to enable each taxable combined group member to offset its capital and Code § 1231 gains and losses against the capital and Code § 1231 gains and losses of the other members of the combined group, whether such other group members are taxable or non-taxable in Massachusetts, when such offsetting is consistent with the unitary business principle and the Massachusetts and federal rules concerning capital and Code § 1231 gains and losses. Pursuant to 830 CMR 63.32B.2(6)(c)8, all of the taxable and non-taxable combined group members' capital gains or losses and Code § 1231 ("§ 1231") gains and losses from the sale or exchange of property are first, as a preliminary step in the calculation of the income of the taxable members of the combined group, segregated from the combined group's taxable income. Those segregated gains and losses are then apportioned or allocated to the taxable group members by applying the specific rules as set forth in said section. The following example illustrates the application of the rules set forth in 830 CMR 63.32B.2(6)(c)8. Although the example set forth below pertains to a situation in which the combined group has not made an affiliated group election, a similar analysis would apply where such election is made.

Example 2. For the 2009 taxable year, corporations X, Y and Z are engaged in a unitary business and are required to file a combined report pursuant to G.L. c. 63, § 32B. Each corporation is taxable in Massachusetts and has a taxable year-end of December 31.[1] Assume for the purposes of this example that all of the members' respective apportionable gains and losses derive from the operation of the unitary business and that none of the members' respective gains or losses are the result of an intercompany transaction.[2] Also assume that the combined group's taxable income for its 2009 taxable year as determined under 830 CMR 63.32B.2(6)(c), before removing the individual members' capital gains or losses and § 1231 gains or losses, is $1,100,000, and that the apportionment percentages of corporations X, Y and Z as determined under 830 CMR 63.32B.2(7) for purposes of filing the group's combined report are 4%, 6% and 3%, respectively. Further, assume that the combined group does not make an affiliated group election pursuant to G.L. c. 63 § 32B and 830 CMR 63.32B.2(10).

As a first step, X, Y and Z's individual capital gains and losses and § 1231 gains and losses are segregated by type and classified as either apportionable or allocable. 830 CMR 63.32B.2(6)(c)8.a. Assume that the respective capital gains and losses and § 1231 gains and losses of the group members for the 2009 tax year are as follows. X has a net apportionable capital loss of $75,000 and a net apportionable § 1231 gain of $100,000, as well as a capital gain of $25,000 that is allocable to another state. Y has a net apportionable capital loss of $40,000 and a net apportionable § 1231 loss of $25,000, as well as capital gain of $10,000 that is allocable to Massachusetts. Z has a net apportionable capital gain of $15,000 and a net apportionable § 1231 gain of $125,000, as well as capital loss of $5,000 that is allocable to Massachusetts.

After segregating and classifying each member's capital gains and § 1231 gains and losses as set forth above, the members' apportionable gains or losses are then aggregated. 830 CMR 63.32B.2(6)(c)8.b. The members have an aggregate apportionable capital loss of $100,000[3] and an aggregate apportionable § 1231 gain of $200,000.[4] This aggregate loss and gain are removed from the combined group's taxable income for purposes of apportioning this group income, such that the combined group's remaining taxable income to be apportioned to the group member's for the taxable year is $1,000,000 (i.e., $1,100,000, increased by $100,000 to reflect the removal of the group's $100,000 aggregate apportionable capital loss, and decreased by $200,000 to reflect the removal of the group's $200,000 aggregate apportionable § 1231 gain).[5]

The group members' aggregate apportionable capital loss and § 1231 gain are apportioned to each group member using the group member's apportionment formula as determined under 830 CMR

63.32B.2(7). 830 CMR 63.32B.2(6)(c)8.b.[6] To determine the respective group member's total capital gains or losses and § 1231 gains or losses to be taxed separately to the member for the taxable year, the individual member's allocable Massachusetts capital gains or losses and § 1231 gains or losses must also be included and combined with the member's apportioned capital gains and losses and § 1231 gains and losses. 830 CMR 63.32B.2(6)(c)8.c-d. The required computation for the individual group members can be illustrated as follows.

(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
Group member	Group apport %	Apport'd share, group § 1231 gain (column (b) x $200,000)	Mass. allocable § 1231 gain or loss	Member's total § 1231 gain ((c)+(d) if >0))[7]	Apport'd share,group capital loss (column (b) x ($100,000))	Mass. allocable capital gain or loss	Member's capital gain or loss (netted = (e)+(f)+(g))
X	.04	$8,000	$0	$8,000	($4,000)	n/a[8]	$4,000
Y	.06	$12,000	$0	$12,000	($6,000)	$10,000	$16,000
Z	.03	$6,000	$0	$6,000	($3,000)	($5,000)	$0[9]

830 CMR 63.32B.2(6)(c)8.c.

The individual group member's net capital gains or loss as stated in column (h) are to be added to the individual group member's apportioned share of the combined group's taxable income (as had been determined by excluding all of the group members' apportionable capital gains or losses and § 1231 gains or losses) to determine the Massachusetts taxable income of each member for the taxable year. The individual group member's apportioned share of the combined group's taxable income, as computed by first removing the combined group's aggregate apportionable capital loss and aggregate apportionable § 1231 gain, as referenced in the text above, is as follows: X, $40,000 (.04 x $1,000,000); Y, $60,000 (.06 x $1,000,000), Z, $30,000 (.03 x $1,000,000). The individual group members' capital gain or loss as determined in the chart above is added to this apportioned income, such that the individual group members have taxable Massachusetts income for the tax year 2009 as follows: X, $44,000 ($40,000 + $4,000); Y, $76,000 ($60,000 + $16,000); Z, $30,000.

IV. Application of 830 CMR 63.32B.2(8)(f); limitation of a taxable combined group member's use of its pre-combination net operating loss carry forwards where the member's losses were incurred in tax years when it was subject to a different apportionment methodology than its current year apportionment method

Prior to the enactment of the combined reporting statute, all Massachusetts net operating losses (NOLs) were to be carried forward by an individual corporate taxpayer to be applied by that taxpayer in future tax years, consistent with the rules for using an NOL carry forward, on a pre-apportionment basis.[10] The Massachusetts combined reporting statute allows a corporation subject to combined reporting that has a NOL carry forward from a tax year prior to its becoming subject to combined reporting to apply that carry forward against its income derived from the activities of the unitary business subject to combined reporting (or from the activities of the combined group generally in the case of an affiliated group election). However, where a taxpayer corporation with a NOL carry forward becomes subject to combined reporting, applying the NOL carry forward on a pre-apportionment basis would have the effect of minimizing the value of the NOL carry forward since the carry forward would be offset against a potentially larger pool of income, i.e., the income of the combined group that includes the taxpayer-corporation that possesses the NOL carry forward. Consequently, the combined reporting regulation includes rules that enable such taxpayer-corporations to utilize their NOL carry forwards against their income as derived from the activities of the unitary business (or the activities of the group more generally in the case of an affiliated group election) on a post-apportionment basis. *See* 830 CMR 63.32B.2(8)(d) and (e).[11]

The regulatory rule governing the use of NOL carry forwards by a taxpayer-corporation that incurred the loss prior to becoming subject to combined reporting, as referenced above, is subject to a limitation that is intended to prevent, *inter alia,* a combined group that includes such a member from transferring Massachusetts property or payroll to such member in an attempt to enhance the post-apportionment value of the member's loss in the context of combined reporting. *See* 830 CMR

63.32B.2(8)(f). The latter limitation generally restricts the loss corporation's post-apportioned NOL carry forward by applying the in-state apportionment factors of the corporation that existed at the time that the loss was incurred, with an election allowed for the use of the loss to be greater in certain cases where the loss corporation progressively increases its in-state Massachusetts property or payroll apportionment factors subsequent to the time of the loss. *Id.* The latter election is intended to permit the NOL carry forward limitation to be less restrictive in the case of a growing company.

Several examples in the combined reporting regulation explain the application of the NOL carry forward rules as those rules apply to the use of a NOL carry forward by a taxable group member when the member's underlying loss was incurred in a tax year prior to such corporation becoming a member of the combined group. *See* 830 CMR 63.32B.2(h), Examples 5-7. However, those examples assume that the loss corporation was subject to a single sales factor apportionment formula for each of the tax years at issue, i.e., the pre-combination tax years in which the underlying losses were incurred and also the tax year in which the taxable group member seeks to use its NOL carry forwards. In contrast, the example below explains the application of the NOL carry forward rules where the loss corporation is subject to one method of apportionment for the combined reporting tax year in which it seeks to use its NOL carry forwards and a different apportionment method or methods during the relevant loss year(s).

Note that, in general, in any case in which a taxable group member has NOL carry forwards from more than one prior pre-combination tax year, the computation to determine the taxpayer's NOL limitation requires four discrete steps, which focus first on the taxpayer's apportionment methodology for *the tax years in which the taxpayer incurred the underlying losses* and second on the taxpayer's apportionment methodology for *the tax year for which the taxpayer seeks to use the NOL carry forwards*. First, a taxpayer's pre-combination pre-apportionment NOLs must be converted to post-apportionment NOLs on a year-by-year basis by using the factor or factors that applied to the corporation for the respective loss years. Second, a determination is made as to what percentage of the taxpayer's total pre-combination post-apportionment NOL that is available for use, as determined in step #1, derives from each of the taxpayer's loss years on a percentage basis. Third, the percentages determined in step #2 are, for each of the taxpayer's loss years, multiplied by the numerator of the taxpayer's apportionment factor or factors for such years, but only as to the apportionment factors that are relevant in the context of the taxpayer's current year apportionment method (i.e., for example, if the taxpayer is to use a single sales factor apportionment method for the current tax year, the year in which it seeks to use a NOL carry forward, it will multiply the percentages determined in step #2 only against its sales factor numerators for each of the loss years).[12] Fourth, the amounts determined for the taxpayer's loss years in step #3 are totaled, resulting in one or more weighted average factor numerators that are then used with the taxpayer's relevant current year denominator or denominators to determine the formula to be applied to the combined group's taxable income for the tax year in which the taxpayer seeks to apply its NOL carry forwards. The amount determined in step #4 is the limit as to the amount of taxpayer's apportioned share of the combined group's taxable income that may be offset by the taxpayer's NOL carry forwards.

The following example illustrates the above-stated rules.

Example 3. Corporation X, a taxable corporation, becomes a member of a combined group for its tax year beginning January 1, 2009, the effective date of the combined reporting statute. Assume that for this tax year the combined group of which X is a member has taxable income of $250,000, and that X's apportioned share of that income, using its applicable single sales methodology, is 6%, or $15,000. For its prior tax years, each of which was a calendar year ending on December 31st, X was not subject to combined reporting. For its three tax years, 2004 through 2006, X was a general business corporation subject to a three-factor double-weighted sales factor apportionment formula – although for its tax year 2004 it was not in fact entitled to apportion its income. For its three tax years, 2007 through 2009 (i.e., including its first year in combined reporting), X was a manufacturing corporation, subject to a single sales factor apportionment formula. X has NOL carry forwards and respective apportionment information for each of its tax years, 2004 through 2009, as set forth below. Note that X's post-apportionment NOL for each of the prior tax years is computed by multiplying its pre-apportionment NOL as determined for that loss year by its apportionment percentage as applied for that year. Note also that it is assumed for purposes of this example that the combined group that includes X does not choose to utilize the election provided for in 830 CMR 63.32B.2(8)(f)2, which is intended to benefit group members that were growing corporations during

the pre-combination period in which such corporations were incurring NOLs.

1. X's pre-combination pre-apportionment NOLs converted to post-apportionment NOLs on a year-by-year basis using the factor or factors that applied to X for the respective loss years. Note that the following information is taken from or derived from X's state tax returns as filed.

	2004	2005	2006	2007	2008	2009
Property						
MA	50,000	30,000	32,000	33,000	40,000	42,000
Everywhere	50,000	60,000	50,000	66,000	80,000	1,000,000
MA Factor	100%	50%	64%	50%	50%	4.2%
Wages						
MA	80,000	80,000	75,000	90,000	100,00	100,000
Everywhere	80,000	90,000	100,000	120,000	150,000	1,000,000
MA Factor	100%	66%	75%	75%	66%	10%
Sales						
MA	150,000	112,500	108,000	86,000	105,000	120,000
Everywhere	150,000	150,000	180,000	200,000	300,000	2,000,000
MA Factor	100%	75%	60%	43%	35%	6%
MA apport. formula						
Applicable method	n/a	(P+W+2S)/4	(P+W+2S)/4	(100%S)	(100%S)	(100%S)
Tax year%	100%	66%	64.75%	43%	35%	6%
NOL carry forwards						
Pre-apport. NOL	$5,000	$20,000	$2,000	$10,000	$5,000	n/a
Post-apport. NOL	$5,000	$13,333	$1,295	$4,300	$1,750	n/a

2. Determination as to what percentage of X's total pre-combination post-apportionment NOLs that are available for use by X in tax year 2009 derive from each of X's respective loss years, tax years 2004-2008.

Given the above facts, X's total NOL carry forward that is available for use in tax year 2009 is $25,678 (i.e., the sum of X's post-apportionment NOLs for the tax years 2004-2008). X's NOL carry forwards from each of the tax years, 2004-2008, make up this total on a percentage basis as follows:

	2004	2005	2006	2007	2008
Post-apport NOL	5,000	13,333	1,295	4,300	1,750
Total NOL avail for use	25,678	25,678	25,678	25,678	25,678
Loss yr. % of total[13]	.195	.519	.050	.050	.068

3. Determination of X's weighted numerators for its loss years, tax years 2004-2008; the percentages determined in step #2 are, for each loss year, multiplied by X's factor numerators for such year, but only with respect to the factor or factors that are relevant for purposes of X's current tax year apportionment, i.e., the sales factor.

Because X is subject to a single sales factor apportionment in the tax year for which it seeks to use its NOL carry forwards, its NOL limitation to be applied, which is determined using the taxpayer's applicable apportionment methodology for the tax year in which it seeks to use its NOL carry

forwards, is to consist only of a sales factor. However, because X's total available NOLs to be used in tax year 2009 derive from more than one tax year X must determine a "weighted average" sales factor numerator for purposes of determining its NOL limitation. The weighted average sales factor numerator is determined by multiplying X's sales as used for purposes of its sales factor numerator in each of its relevant loss years, 2004-2008, by the percentage determined in step #2, *supra*, i.e., the percentage of X's total available NOL carry forward that derives from each of these loss years. This calculation is done separately for each of X's loss years, and the results are then totaled. For purposes of the calculation X's sales factor numerator in each of the loss years is to exclude all "throwback" sales other than destination sales "thrown back" in such year from jurisdictions in which no member of the current year combined group is subject to tax. *See* 830 CMR 63.32B.2(8)(f)1.a. The computation for X can be illustrated as follows. Note that the computation below includes the use of additional facts to be assumed for purposes of this example, pertaining to the throwback sales that are to be eliminated from X's sales factor numerator as included on X's previously-filed state income tax returns.

	2004	2005	2006	2007	2008
Numerator on return	150,000	112,500	108,000	86,000	105,000
Adjust, for throwback sales[14]	(15,000)	(15,000)	(10,000)	(10,000)	(10,000)
Revised numerator	135,000	97,500	98,000	76,000	95,000
NOL from such yr as % of total[15]	.195	.519	.050	.167	.068
Weighted sales factor numerator[16]	26,287	50,626	4,942	12,727	6,474

4. The sum of the amounts determined for the tax years in step #3 are totaled, resulting in X's weighted average sales factor numerator to be set forth over X's relevant current year sales factor denominator to determine the formula to be applied to the combined group's taxable income for the year in which the taxpayer seeks to apply its loss carry forwards.

The sum of X's weighted sales numerators for its tax years 2004-2008 as determined in step #3 supra, is $101,056. To determine the limitation on X's use of its total NOL carry forwards available for use in tax year 2009 this weighted sales factor numerator is placed over X's sales factor denominator for its 2009 tax year, and multiplied against the combined group's taxable income for its 2009 tax year. The limitation thus determined is $12,632 (i.e., 101,056/2,000,000 x $250,000). Therefore, X may only use $12,632 of its total NOL available for use, $25,678, in tax year 2009. This limited NOL carry forward may be applied against X's 2009 apportioned share of the combined group's taxable income, $15,000. The remainder of X's NOL carry forwards may be carried forward to offset X's tax liability in future tax years consistent with the rules that apply to the use of such NOL carry forwards. *See* 830 CMR 63.32B.2(8).

V. Application of 830 CMR 63.32B.2(8)(g) and (h), Example 7; correction of an error in the example stated at 830 CMR 63.32B.2(h), Example 7

The combined reporting regulation, 830 CMR 63.32B.2, includes a provision set forth at 830 CMR 63.32B.2(8)(g), which explains the relationship between allocable and apportionable losses and loss carry forwards. Further, the regulation includes in the immediately subsequent section, 830 CMR 63.32B.2(8)(h), an example, at 830 CMR 63.32B.2(8)(h), Example 4, that illustrates the provisions of 830 CMR 63.32B.2(8)(g). The Department has determined that said Example 4 as set forth in the regulation is wrong in certain respects and should be restated as follows in this Directive (note that the newly added language in the following revised example is marked in italics, whereas the language to be removed from the regulatory example is not referenced in the text below). The Department further serves notice that it will subsequently amend the example in the regulation so that it is restated as follows in this Directive.

Example 4. Y and Z are corporations taxable under M.G.L. c. 63, § 39 that are engaged in a

unitary business during the three year period 2009-2011. For taxable year 2009, the YZ combined group's taxable income is $100,000 and the apportionment percentage of Y and Z is 10%, and 5% respectively. Z also has an allocable loss of $20,000 that derives from an activity that is unrelated to the combined group's unitary business. The apportioned taxable income of Y and Z derived from the combined group prior to the deduction of any losses is $10,000 and $5,000, respectively. Z applies its allocable loss, $20,000, against its apportioned share of the combined group's taxable income, $5,000 and has a remaining loss of $15,000 to carry forward. Z's $15,000 loss carry forward is an allocable loss, and therefore cannot be shared with Y in the 2009 tax year or any future tax year. For taxable year 2010, the YZ combined group has a net loss of $50,000 and the apportionment percentage of Y and Z is 10% and 6%, respectively.

For taxable year 2010, the YZ combined group has a net loss of $50,000 and the apportionment percentage of Y and Z is 10% and 6%, respectively. Therefore, Y and Z ***have current year apportioned losses of $5,000 and $3,000, respectively. Y has no other income and generates a NOL carry forward of $5,000.*** Because ***this carry forward is*** derived from the operation of the combined group's unitary business, Y may share the NOL with Z in future years. ***Z also has allocable income from 2010 of*** $8,000. ***Z must combine its separate income and its share of the loss from the unitary business and has $5,000 of taxable net income before considering its NOL from prior years.*** Z's allocable loss from 2009, $15,000, is deducted from its allocable income from 2010, $5,000, up to the limit specified in M.G.L. c. 63, § 30.5 (*i.e*., in this case, reducing Z's taxable income to zero). Z retains the remainder of its 2009 allocable NOL derived from 2009, i.e., $10,000, which Z can carry forward and use against its own income (but which cannot be shared with Y) in future years.

For taxable year 2011, the YZ combined group has net income of $200,000 and the apportionment percentage of Y and Z is 10% and 4%, respectively. Therefore, Y and Z's apportioned share of the combined group's taxable income is $20,000 and $8,000, respectively. Neither Y nor Z has any allocable income or loss in 2011. Y applies its NOL carry forward previously derived from the activities of the YZ combined group, $5,000, against its $20,000 in 2011 apportioned income from such group, and thereby reduces this income to $15,000. ***Z has no NOL carry forward previously derived from the activities of the YZ combined group, but*** Z may apply ***$8,000*** of its allocable NOL against its remaining 2011 apportioned income from the YZ group, thereby reducing this income to zero. Z retains the remainder of its 2009 allocable NOL, *i.e*., ***$2,000****,* which Z can carry forward and use against its own income (but which cannot be shared with Y) in future years.

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[1] Although each corporation in the group is taxable in Massachusetts, the same general analysis in this example would apply if one of the group members was not taxable in Massachusetts, as each taxable combined group member is to offset its capital and Code § 1231 gains and losses against the capital and Code § 1231 gains and losses of the other members of the combined group, whether such other group members are taxable or non-taxable in Massachusetts. (Note that in the case of a combined group that has not made an affiliated group election, the offset is with respect to such gains and losses as derived from the unitary business.)

[2] In the case of an intercompany transaction, the resulting gain or loss is typically deferred. *See* 830 CMR 63.32B.2(6)(c)5.

[3] Mechanically, this number is determined by adding together the three corporations' respective apportionable capital gains and losses of ($75,000), ($40,000) and $15,000.

[4] Mechanically, this number is determined by adding together the three corporations' respective apportionable § 1231 gains and losses of $100,000, ($25,000) and $125,000.

[5] It should be noted that if the totaling of the group members' § 1231 apportionable gains and losses was to result in an aggregate § 1231 loss, the aggregate loss and the group members' various items of § 1231 apportionable gains and losses resulting in the aggregate loss would not generally be considered in determining the group members' net capital gain or loss, but rather the taxable group members' would each receive their apportioned share of the § 1231 loss, which would then be added to, or offset against, those individual group member's allocable items of § 1231 gain or loss, it any. If an individual taxable group member were to end up with a resulting § 1231 loss that loss would be treated as an ordinary loss, whereas a resulting § 1231 gain would generally be treated as a capital gain against which the member would be able to offset its capital losses.

[6] The removal of the group's capital gains or losses and § 1231 gains or losses from the combined group's taxable income does not by itself have any effect on the computation of the group members' apportionment factors as determined under 830 CMR 63.32B.2(7). 830 CMR 63.32B.2(6)(c)8.

[7] *See* footnote 5 for a discussion of the required analysis in the instance in which the group members' apportioned § 1231 losses from the unitary business exceed their § 1231 gains.

[8] The determination of the group member's total taxable Massachusetts capital gains or losses and § 1231 capital gains or losses is determined without consideration of the members' capital or § 1231 gains or losses that are to be allocated to states *other than Massachusetts.* 830 CMR 63.32B.2(6)(c)8.c. Therefore, in this case, X's $25,000 of capital gain to be allocated to a state other than Massachusetts is not considered in the computation.

[9] Z's excess capital loss (the difference between columns (f) and (g)) cannot be offset against its current year Massachusetts taxable income or carried forward to a subsequent year. 830 CMR 63.32B.2(6)(c)8.d.

[10] This rule has changed for tax years beginning on or after January 1, 2010. *See* Acts of 2010, c. 240, §§ 122, 203. For tax years beginning on or after January 1, 2010, all carry forward losses are to be carried forward on a post apportioned basis. *See id.*

[11] A NOL carry forward that derives from a loss incurred by a taxable combined group member for a tax year in which the member was not subject to combined reporting can only be used by such member and cannot be shared with the other members of the combined group.

[12] In the instance of the sales factor, the numerator for the loss years must also be adjusted to eliminate "throwback" sales that would not be throwback sales within the meaning of the combined reporting regulation. *See* 830 CMR 63.32B.2(7)(b) and (c).

[13] This number is line 1 divided by line 2.

[14] The numbers referenced on this line are assumed for purposes of this example.

[15] From step #2, *supra*.

[16] The number on this is determined by multiplying line 3 (X's sales factor numerator for the year in question adjusted to exclude certain throwback sales) by line 4 (X's post apportioned NOL from the loss year in question that is available to be used as a percentage of X's total NOL carry forward that is available to be used).